Must the United States as a Creditor Nation Modify Its Traditional Attitude toward a Protective Tariff?

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THE traditional attitude of the United States toward a protective tariff may be said, with as much accuracy as commonly attaches to such generalizations, to have consisted in the belief that any American industry which, if subsidized through governmental action at a rate not exceeding or not greatly exceeding the foreign cost of production, has any chance of surviving, should be given such a subsidy indirectly in the shape of import duties on competing foreign products. There are few American economists who would unqualifiedly give their approval to this attitude even under conditions such as were prevalent in the pre-war period. But the question now raised, namely, "Must the United States as a creditor nation modify its traditional attitude toward a protective tariff?" narrows the issue somewhat. Whatever the pros and cons of protection may have been during the pre-war period, the issue now presented is, "Has the change in conditions, whereby the United States has ceased to be a debtor nation and has become a creditor nation, made it not only desirable but necessary that its traditional policy of tariff protection be replaced by a policy of more or less unrestricted import trade?"

The creditor status brings with it certain inevitable consequences in connection with the foreign trade: Exports, visible and invisible, commodity and service, pay for imports, visible and invisible, commodity and service. In the absence of deferred payment or credit transactions, exports must equal imports. The American loans to Europe caused a corresponding excess of exports over imports, because the loans took the form of shipments of goods and the offsetting imports were deferred to a later period. The repayment by Europe of the principal of the American loans would in similar manner be effected in goods (or services) and would cause an excess of imports into the United States over exports from the United States. It is not so much the repayment of the principal of the American loans as the payment of interest on these loans which presents the imminent problem with regard to the foreign trade of the United States.

The use of American capital by Europe may reasonably be regarded as equivalent for each year of such use to the export from the United States of a capital service. The interest paid for the use of this service must reach the United States in the form of the import of goods or services or both. The so-called unfavorable balance of trade which is being so generally predicted for the period when Europe will begin paying interest on her debts will not, therefore, be an excess of total imports into the United States, commodity and service, over total American exports, commodity and service, but *will* be a sufficient excess of imports, commodity and service, over exports, commodity and service *other than capital service*, to pay for the export of capital service at the contractual rates.

At the present time, the process of capital exportation, *i.e.*, the investment of American capital abroad, is still continuing, and the American exports, commodity and service, are still in excess of the American imports,

If the outward flow of capital ceases before substantial payment of interest begins, there will be an equilibrium between imports and exports *other* than capital service, presumably with exports smaller than they now are and imports not substantially different from what they now are. When interest payments begin, they can be ultimately mediated in any of several different ways. Europe may meet her interest obligations by selling more goods or services to the United States, or by refraining from taking American goods or services to which she would otherwise be entitled; or by a combination of these two methods, *i.e.*, selling more to the United States and buying less from them. The only other possibility is that by continued extension of American loans abroad or by new investments abroad the date of the payment to the United States of interest shall be indefinitely postponed. This, however, would merely defer the problem of adjustment of exports and imports, and would not solve it.

The adjusting factor in any case will be the relative (gold) price levels of different countries. Europe will be able to meet her interest obligations to the United States only if European prices fall relative to American prices, so that European exports to the United States are encouraged, and European imports from the United States are discouraged. Because a rise in prices in one country relative to the world price level would tend to check exports as well as to encourage imports, it may be expected, whatever governmental policy may be, that the settlement by Europe of her interest obligations to the United States will result both in an increase in imports to America and a decrease in exports from America as compared with what they would have amounted to, respectively, if the interest obligations were not present.

Governmental policy can, however, affect the degree in which the obligations are met by one method or the other. A high tariff on European products, for instance,—and the present tariff is high if measured by non-American standards—would accentuate the rise in American prices in relation to the world price level, the high tariff would prevent foreign commodities from benefiting from these high prices, and the high prices would cut off exports from America. A high tariff policy would not only injure our export trade, but it would also make it much more difficult, and perhaps even impossible, for Europe to meet her obligations in any manner. Assuming that a high tariff had no such extreme effect, and that the European obligations were met, they could be met only through a substantial reduction in the European purchases of American products.

In so far as government policy can determine the choice between alternatives, it must decide either to leave the flow of imports substantially unchecked or to take action which by restricting imports will check the flow of exports. There will inevitably be a conflict of interest between the domestic producers for the home market who fear unrestricted foreign competition on the one hand, and the domestic producers of commodities for export on the other.

The United States Government has lent to foreign governments almost \$10,000,000,000, and it is estimated that, since 1914, \$3,500,000,000, more or less, of American capital has been privately invested in foreign countries. If to this amount be added the accumulation of unpaid interest, and the withdrawal from the United States of foreign capital since 1914, it is probably a conservative estimate that the United States now has an annual credit item of \$800,000,000 to \$1,000,000,000, due

to it annually in interest, over and above the net debit or credit of interest transactions in 1914. Shall the United States' claim to interest payments be liquidated in the form of increased imports or in the form of lessened exports? This is the issue stated baldly which requires determination.

Europe, it is true, need not pay her obligations wholly in commodities. Every sale of a service to an American serves to liquidate indebtedness to the United States in the same manner as an equivalent sale of commodities. But the importation of services instead of commodities offers no avenue of escape from this alternative of unrestricted flow of imports or indirect restriction of exports. Before the war Europe sold to the United States each year services amounting in value to very nearly the value of her sales of commodities. There is little prospect that the American purchases of such services will be substantially greater in the next decade than they were in the decade preceding the war. In so far as the most important of these services, freights, is concerned, the United States is already in the position, as the result of the building up of a great merchant marine, where it sells more freight service than it buys. Here, therefore, we may expect a decrease in the purchases of service from Europe instead of an increase.

Americans with leisure time and surplus income during the war period were perforce obliged to do their traveling on this Continent, and the habits then developed under stress of war conditions may leave as an aftermath a lessened tourist traffic abroad. In any case, little can be expected from this quarter in the way of an increase of American debit obligations over the annual pre-war amount sufficient to liquidate even a substantial fraction of the European interest obligations, With respect to bankers' and insurance services, also, it is probable that, as a result of wartime developments, the American purchases thereof from abroad will be smaller instead of greater in the post-war period as compared to the pre-war period.

The so-called non-commercial items such as the remittances of aliens in the United States to their relatives in the home countries may indeed expand, especially if economic conditions in Europe continue to be in their present parlous state. One can not find here, however, an offsetting debit item for \$800,000,000 to \$1,000,000,000 of annual credits. If immigration should be restricted, however, the capital which it brings with it and which ultimately enters in the form of imports of commodities will also be shut out, and this will make it so much the easier for the American industrial system to absorb an otherwise increased flow of imports.

It has been argued that Europe need not meet her obligations to the United States directly through the shipment of manufactured commodities, but that through triangular exchange transactions European shipments of manufactured products to Latin America and to the Orient may there establish credits for the United States, to be drawn upon for the purchase of raw materials. Thus American industries would continue to be protected against European competition, and, at the same time, Europe could meet its obligations to the United States. To some extent, at least in theory, this is a potential solution of the problem. It raises, however, its own problems in turn. In the first place, there is the question as to whether Europe can find a market in addition to her normal one in these regions sufficient to absorb at reasonable prices a great addition of commodities. In the second place,

can the United States in turn become a purchaser of the restricted range of products of these regions in quantities so much greater than the normal quantities that they will suffice to liquidate by indirect exchange the obligations of Europe to this country? Third, this, even if feasible, would not really be a solution of the problem we are considering, but would simply be a shifting of its incidence from domestic manufacturers who fear European competition to domestic farmers who now have perhaps an even greater fear of South American and Asiatic competition.

It should be clear, therefore, that, whether Europe makes settlement of her obligations directly or indirectly, such settlement must ultimately take the form of either an increase in American imports or a decrease in American exports. It is hard to refrain from regarding the present problem as merely a special case to which the general principles of international trade which form the basis of the free-trade argument are especially applicable. A prohibitive tariff would mean a high price level, high money costs of production, high money wages. It would thus place handicaps on exporting industries just at the critical period in their development, when they are most in need of an open field without favor and without handicap, in order that their right to the employment of American capital and labor in competition with other American industries and in competition with the world may be fairly tested. It would eliminate ocean freight traffic just when a national merchant marine has been constructed at tremendous cost for the very purpose of handling such freight traffic. It would offer the sorrowful spectacle of a government on the one hand liberally expending its revenue in export trade promotion, and on the other hand passing laws which would be bound to have as their most conspicuous effect the cutting-off of export trade.

The political background of tariff protection is rapidly shifting. An increasing number of manufacturing industries have attained the position where they can without subsidy meet foreign competition, not only in the domestic market, but also in foreign markets. To such industries prohibitive tariff duties would be a burden instead of a help. On the other hand, for some of the important agricultural products, the situation is being reached where the United States is changing from a surplus to a deficiency country and where import duties would no longer be nominal in their effect but would raise the domestic price. The tariff histories of England, France and Germany all offer instances of the phenomenon where, as these countries changed from exporters of agricultural commodities to importers, the farmer class shifted from advocates of free trade to the chief supporters of protectionism. That same process is visibly under way in the United States. Manufacturers are beginning to give voice to the good old free trade doctrines of the farmers, and farmers are beginning to find truth in the traditional protectionist arguments of the manufacturers.

When economic class interests change, it does not take long for the economic doctrines of these classes to change in conformity. If to the protectionism of those manufacturers who, not confident in the economic soundness of their industries, fear Europe paying her debts, there is to be added the new protectionism of the farmers, American export trade may indeed prepare to be shackled.

Were it to be expected that the European payments would take the form of a huge flood of imports over a relatively short period of time during

which they might seriously disturb the whole domestic economic machine, there would be substantial cause for forebodings and for precautionary measures. But the payments of principal will be met by Europe only if spread over a long period of time—if it is not undue optimism to expect that they will not have to be largely written off as bad debts. If anything is to be feared during the next decade, it must be the interest payments. These, while substantial enough *if fully paid*, are but a small fraction of the annual output of American industry, and not great enough to disturb the smooth working of a great economic system, resting on solid foundations.

The policy of the government will be decided by the victor in the clash of group interests. Were political conditions now what they were before 1914, it would be a safe prediction that the manufacturers would have their own way. They are now divided among themselves, however, and the farmers are much better organized than they ever were before. It is in the general interest that the efforts of the exporting manufacturers to check restrictive legislation shall be successful. It would be, however, the irony of fate if the rôles of beneficiary and victim should now be reversed, and if the tariff, which for almost a century the manufacturers imposed on the farmers to the benefit of the former and to the injury of the latter, should now turn upon the manufacturers and force them to give largesse to the farmers.

The Effect of Depreciated Exchange on Foreign Trade

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In the conduct of business many unavoidable risks are encountered. To perceive the risks that must be incurred is much, but it is also of vital importance to understand their nature and probable consequences. Risks which are perceived but not understood are altogether likely to become the foundation for exaggerated fears. This seems to be the present situation as regards the probable consequences of depreciated foreign exchange rates upon both the export and the import trade of the United States.

Stated in summary fashion, the reasoning which forecasts disastrous results to the foreign trade of the country from depreciated exchange rates runs somewhat as follows: With sterling at $4.00 it is argued that the British producer can sell at a good profit in the United States goods which could not be profitably marketed here with sterling at par, *i.e.*, at $4.86. At the depreciated rate, he will receive on the sale of goods for $1,000 in the United States £250 instead of the £210 which he would have secured when exchange was at par. Here would indeed appear to be a prodigious stimulus to the export business of a country on a depreciated basis, and also a similarly great obstacle to imports.

But this is not the whole story. That there must be counteracting influences at work is to be presumed from the absence of any instance of extraordinary increase in exports and decline in imports in the case of countries which in the past have gone upon an inconvertible basis.[1] Consideration of

[1] The experience of European countries since the war is, of course, too short to provide an adequate basis for conclusion on this matter.